

INTERNAL REVENUE SERVICE
Director, Exempt Organizations

DEPARTMENT OF THE TREASURY
1100 Commerce Street
Dallas, Texas

Date: MAY 17 2000

Employer Identification Number:
[REDACTED]

Person To Contact:
[REDACTED]

Telephone Number:
[REDACTED]

In Reply, Refer To:
[REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986.

The information submitted discloses that you were incorporated on [REDACTED]. Your purposes as stated in your organizing document are to serve as a non-profit organization of the [REDACTED] located within the boundaries of property identified in the Articles Of Incorporation.

A Form 1023 application for tax exempt status under IRC 501(c)(3) was received from your organization on [REDACTED]. After further consideration, you submitted a Form 1024 application to apply under IRC 501(c)(4) instead. The [REDACTED] Form 1024 application was received on [REDACTED].

All requests to your organization for additional information have been sent to the organization's address on the Form 1024 application, and all responses to those requests have been issued from the office of [REDACTED]. No executed Power of Attorney for [REDACTED] has been submitted.

The Form 1024 application noted that your organization would form an architectural control committee, interpret and enforce restrictive convention and provision for assessments, and liens with respect to the ownership, maintenance, and use of the property, as well as maintain common areas. Section 4.2 of the Articles of Incorporation reads "to interpret and enforce restrictive covenants and provisions for assessments, and liens with respect to the ownership, maintenance, improvement and use of the property." (Emphasis added)

The cover letter accompanying the Form 1024 application stated that the common areas are open to the general public. However, question [REDACTED], in Letter [REDACTED] issued to your organization on [REDACTED] asked, "Please identify and define the community that will benefit from your organization's activities." To which you answered through a correspondence from [REDACTED], dated [REDACTED], [REDACTED] "The residents and their guests to the area." In addition you indicated that the farms were not operating farms, but residential sites, and that the governmental unit boundaries within which the organization resided was [REDACTED]. You also indicate the tract of land covered approximately [REDACTED] acres.

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Correspondence issued by [REDACTED] indicated that the maximum number of farms would be [REDACTED] based on the current acreage. The correspondence was issued in response to a request for information issued to your organization by the agent on [REDACTED]

Section 501(c)(4) of the Internal Revenue Code provides exemption to:

(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(B) Subparagraph (a) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Revenue Ruling 72-102, 1972-1 C.B. 149 reads as follows:

"A nonprofit organization formed to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for use of the residents is exempt under section 501(c)(4); however, contributions to the organization are not deductible under section 170 of the Code; Revenue Ruling 69-280 distinguished.

Section 501(c)(4) of the Code provides for exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

For the purposes of section 501(c)(4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development. Even though the organization was established by the developer and its existence may have aided him in selling housing units, any benefits to the developer are merely incidental. Also, even though the activities of the organization serve to preserve and protect property values in the community, these benefits that accrue to the property owner-members are likewise incidental to the goal to which the organization's activities are directed, the common good of the community. Therefore, it is held that the organization is exempt from Federal income tax under section 501(c)(4) of the Code. Contributions to it are not deductible by donors under the provisions of section 170(c)(2) of the Code."

Excerpts from Revenue Ruling 74-99 provides further clarification both on the term community, and the use of common areas as follows:

The Internal Revenue Service has been requested to clarify the circumstances in which an organization similar to the homeowners' association described in Rev. Rul. 72-102 may qualify for exemption under section 501(c)(4) of the Internal Revenue Code of 1954.

Thus, notwithstanding the combination of characteristics which the organization in Rev. Rul. 72-102 has in common with many other homeowners' associations, it was considered to have established its qualification for recognition of exemption as an organization described in section 501(c)(4) of the Code. In reaching this conclusion Rev. Rul. 72-102 reads, in part, as follows: "For the purposes of section 501(c)(4) of the Code, a neighborhood, precinct, subdivision, or housing development may constitute a community. For example, exempt civic leagues in urban areas have traditionally represented neighborhoods or other subparts of much larger political units. By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development."

Increasing experience with homeowners' associations of this general kind has demonstrated, however, that the Revenue Ruling does not delineate the bases for the favorable holding in the case clearly enough to prevent misconceptions as to its scope. Specific questions have been raised as to (1) the scope of the term "community" as used in the ruling; (2) whether an organization whose program includes activities devoted to exterior maintenance of private residences comes within the ambit of the ruling; and (3) the interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal governments."

One misconception generated by Rev. Rul. 72-102 is that the ruling appears unqualifiedly to equate a housing development with the term "community" within the meaning of section 501(c)(4) of the Code, thereby giving rise to the implication that any housing development may qualify as a community for exemption purposes regardless of any other attendant facts and circumstances in the case. Rev. Rul. 72-102 is hereby modified to reject its apparent acceptance of such a narrow definition of "community" for purposes of section 501(c)(4). {Emphasis added}

A community within the meaning of section 501(c)(4) of the Code and the regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. Although an exact delineation of the boundaries of a "community" contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

Another aspect of Rev. Rul. 72-102 that has given rise to some misconception of the ruling's scope involves interpretation of the phrase "non-residential, non-commercial properties of the type normally owned and maintained by municipal government" in determining what kinds of common areas or facilities an exempt homeowners' association may own and maintain. The Revenue Ruling in reciting the areas and facilities owned and maintained by the organization speaks only of "common green areas, streets, and sidewalks." The Revenue Ruling was, by the quoted phrases, designed to indicate that the only areas and facilities encompassed were those traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety, and welfare. Thus, the Revenue Ruling was intended only to approve ownership and maintenance by a homeowners' association of such areas as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public, as distinguished from controlled use or access restricted to the members of the homeowners' association, as appropriate and consistent with exemption for the association. Rev. Rul. 72-102 is modified accordingly.

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Although Revenue Ruling 72-102 facilitated tax exempt status under IRC 501(c)(4) for organizations formed to preserve the appearance of a housing development, and to maintain streets, sidewalks and common areas for the use of the residents, Revenue Ruling 74-99 clarified and narrowed the scope of both what is considered to be a community, and what is considered to be a common area for purposes of exemption for this type of organization.

Revenue Ruling 74-99 indicates that the term community as used in IRC 501(c)(4) needs to be "a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof." The maximum number of residences included in your organization would be ██████, in an area covering ██████ acres. This number of residences spread over a ██████ acre area of land cannot reasonably be considered to be a community. This is especially the case, since the ██████ acre tract with its ██████ farm residences bears no resemblance to a governmental subdivision, or a unit, or district of such a subdivision; nor, has it been designated as such.

Since the residents and their guests to the area have been identified as the "community that will benefit from the organization's activities", the maintenance of roads, alleys and other such property will be for the private benefit of the residents and their friends, and not the general public. Revenue Ruling 74-99 indicates that maintenance of common areas must be for the use and enjoyment of the general public, and not just the residents. If no one (but with rare exception) is expected to use the common areas of the tract but the residents, and their friends who come to visit, the maintenance of common areas could not reasonably be considered to be for the use and enjoyment of the general public.

We have considered your application for exemption from Federal Income Tax under Section 501(c)(4) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section and must file Federal income tax return Form 1120 or 1120-H (Homeowner's organization).

If you agree with these conclusions or do not wish to file a written protest, please sign and return Form 6018 in the enclosed self-addressed envelope as soon as possible.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law and argument which clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. A conference will be arranged in the Regional Office after we have had an opportunity to consider the brief and it appears that the conclusions reached are still unfavorable to you. Any submission must be signed by one of your principal officers. If the matter is to be handled by a representative, the Conference and Practice Requirements regarding the filing of a power of attorney and evidence of enrollment to practice must be met. We have enclosed Publication 892, Exempt Organization Appeal Procedures for Adverse Determinations, which explains in detail your rights and procedures.

If you do not protest this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service".

Please keep this determination letter in your permanent records. If we do not hear from you within 30 days from the date of this letter, this determination letter will become final.

[REDACTED]

If you have any further questions, please contact the person whose name and telephone number is shown above.

Sincerely yours,

Steven T. Miller

Steven T. Miller
Director, Exempt Organizations

Enclosures:
Publication 892
Form 6018
Return Envelope